

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WOODLAND PRESTON)	
ENTERPRISES, INC. FOR A RATE ADJUSTMENT)	CASE NO.
PURSUANT TO THE ALTERNATIVE RATE FILING)	92-278
PROCEDURE FOR SMALL UTILITIES)	

O R D E R

On July 8, 1992, Woodland Preston Enterprises, Inc. ("Woodland") filed its application for Commission approval of a proposed increase in its rates for sewer service. Commission Staff, having performed a limited financial review of Woodland's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 16th day of September, 1992.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WOODLAND)	
PRESTON ENTERPRISES, INC FOR)	
A RATE ADJUSTMENT PURSUANT TO)	CASE NO. 92-278
THE ALTERNATIVE RATE FILING)	
PROCEDURE FOR SMALL UTILITIES)	

STAFF REPORT

Prepared By: Jack Scott Lawless, CPA
Public Utility Financial
Analyst
Water and Sewer Revenue
Requirements Branch
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Prepared By: Brent Kirtley
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STAFF REPORT
ON
WOODLAND PRESTON ENTERPRISES, INC.
CASE NO. 92-278

A. Preface

On July 8, 1992, Woodland Preston Enterprises, Inc. ("Woodland") filed its application with the Kentucky Public Service Commission ("Commission") seeking approval to increase its tariffed sewer rates by 118 percent, an increase in annual operating revenues of \$4,245.

In order to evaluate the requested increase , the Commission Staff ("Staff") chose to perform a limited financial review of Woodland's operations for the test period, the twelve month period ending December 31, 1991. Jack Scott Lawless, CPA, of the Commission's Division of Rates and Tariffs and Brent Kirtley of the Commission's Research Division conducted the review on August 5, 1992 at Woodland's office in Paintsville, Kentucky.

The findings of the field review have been reduced to writing in this report. Mr. Kirtley is responsible for the sections related to operating revenues and rate design. The remaining sections of this report were prepared by Mr. Lawless. Based upon the findings of this report, Staff recommends that Woodland be allowed to increase its normalized operating revenues by \$4,224.

Scope

The scope of the review was limited to obtaining information to determine whether test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

During the course of the review, Woodland was advised that all proposed adjustments to test year expenses must be supported by some form of documentation and that all such adjustments must be known and measurable.

B. Analysis of Operating Revenues and Expenses

Operating Revenue

Woodland-Preston reported test-year revenue of \$2,451. Its application indicates that, at the time of filing, there were 31 connections. However, during the test period and at present there are only 29 connections being utilized. This number of customers would generate \$2,784¹ in revenue annually at current rates, a difference of \$333 over actual test-period revenue collected.

Operating Expenses

Woodland reported operating expenses of \$2,538 for the test year which it proposed to increase by \$4,158. Staff has calculated pro forma adjustments to the operating expenses in the amount of \$3,467 net of income taxes. Staff's adjustments are shown on Appendix B attached to this report. Woodland's and Staff's pro forma adjustments to test period operations are discussed in the following sections of this report.

Outside Services

Woodland reported test year outside services expense of \$572. This account included payments to Sue Phelps, a certified operator, for monthly inspections; payments to Woodland's CPA for the preparation of

¹ Flat Rate of \$8.00 per month x 29 customers x 12 months = \$2,784

tax returns and annual reports; and payments to Environmental Monitoring Services for water testing services in the amounts of \$220, \$250 and \$102, respectively. In its application Woodland proposed to increase operating expenses by \$1,600 with adjustments of \$1,300 to servicing costs and \$300 to return preparation costs.

During Staff's review it was discovered that Mr. E.J. Preston, the owner and manager of Woodland, was no longer able to service the treatment plant due to his health. Therefore, Appalachian Waste Control Servicing Co. was retained by Woodland to perform weekly inspections and to service the treatment plant as needed. Appalachian Waste Control Servicing Co. charges Woodland \$25 per week for these services. In order to evaluate the reasonableness of Appalachian Waste Control's charges, Staff contacted Mr. Larry Updike of the Commission's Division of Engineering. Mr. Updike informed Staff that weekly inspections of the treatment plant were not unreasonable since Mr. Preston is no longer able to service the treatment plant.

Staff is of the opinion that operating expenses should be adjusted to include the \$1,300 expense associated with Appalachian Waste Control, however, Staff has reduced operating expenses by \$220 to eliminate the cost of inspections by Sue Phelps that will no longer be necessary as a result. This produces a net increase in operating expenses of \$1,080.²

²	Weekly expense	\$ 25
	Annualize	<u>52</u>
	Pro forma	1,300
	Less: Test year	<u>(220)</u>
	Adjustment	<u>\$ 1,080</u>

Woodland proposed to increase operating expenses by \$300 due to an increase in the accountant's annual fee for the preparation of tax returns and annual reports. Staff contacted Woodland's accountant, Willis Newsome, CPA, regarding this adjustment. Mr. Newsome gave no indication that his charge of \$250 will increase to \$300. Furthermore, Woodland's adjustment does not take into consideration the \$250 payment to Mr. Newsome already included in test year operating expenses. Therefore, Staff is of the opinion that this adjustment should not be accepted for rate making purposes.

During its investigation, Staff discovered that only 3 quarterly payments for water testing were included in test year outside services. Staff has made the appropriate adjustment of \$34³ to properly reflect water testing at the pro forma level.

Owner/Manager Fee

Woodland proposed an adjustment to operating expenses in the amount of \$2,400 for administrative expenses. In its application Woodland states that this reflects the yearly costs incurred in managing the corporation. Staff is of the opinion that Woodland is entitled to an owner/manager fee in the amount of \$2,400. The acceptance of a fee of this nature is a common practice of this Commission when setting rates for small investor owned sewer utilities where the owner manages the

³ Quarterly expense	\$ 34
Annualize	<u>4</u>
Pro forma	136
Less: Test year	<u>(102)</u>
Adjustment	<u>\$ 34</u>

utility without charging a salary to the operating expenses of the utility. In Woodland's case, this fee serves as compensation for services provided by E. J. and Grayce Preston, office materials and supplies, office and vehicle rent and telephone expenses. Therefore, Staff has adjusted test year operating expenses to reflect the \$2,400 owner/manager fee.

Miscellaneous Expense

Woodland proposed to increase operating expenses by \$158 to reflect the cost of office supplies. Although Staff requested all information supporting Woodland's proposed adjustments in its confirmation letter dated July 24, 1992, Woodland did not provide such data related to this adjustment. Staff is of the opinion that this adjustment is not known and measurable and therefore, should not be considered for rate making purposes.

Depreciation

Although the Commission allows a utility to recover the cost of its utility plant in service through depreciation, Staff is of the opinion that Woodland should not be allowed to recover any portion of the utility plant that was placed into service as a result of a contribution in aid of construction. Staff has adjusted test year depreciation

expense by \$24⁴ in order to reflect depreciation on utility plant in service which was funded by the utility.

School Tax

Woodland reported test year school tax expense of \$23. Woodland is acting as an agent of the taxing authorities to collect and remit school tax. Accordingly, these monies should not be reported by Woodland as either an operating revenue or expense.

Woodland's normalized operating revenues do not reflect the collection of the school tax and thus, Staff recommends that test year operating expenses be reduced by \$23 to reflect the elimination of the school tax expense.

C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for small, privately owned utilities is an 88 percent operating ratio. Staff recommends the use of this approach plus a dollar for dollar recovery of income taxes in determining Woodland's revenue requirements.

⁴	UPIS	\$ 15,446
	Less: CIAC	<u>(600)</u>
	Depreciable plant through rates	14,846
	Divide by: 25 years	<u>25</u>
	Pro forma	594
	Less: Test year	<u>(618)</u>
	Adjustment	<u>\$ (24)</u>

Staff's adjusted operations provide Woodland with an operating ratio of 216 percent⁵. Combined with Woodland's proposed increase of \$4,245, the result is an operating ratio of 85 percent⁶. When using the approach recommended by Staff, Woodland's revenue requirements are \$7,008⁷. Staff recommends that Woodland be allowed to increase its normalized operating revenue by \$4,224⁸.

D. Rate Design

In its application, Woodland-Preston filed a schedule of present and proposed rates and did not propose any changes in the rate structure. The Staff is in agreement that the present rate structure should not be altered. Therefore, any increase granted in the case has been added to the existing rate structure. The Staff recommends that

⁵ $\$6,005 / \$2,784 = 216\%$

⁶ $\$6,005 / (\$2,784 + \$4,245) = 85\%$

⁷	Recommended operating expense	
	before income taxes	\$ 6,005
	Divide by: Operating ratio	<u>88%</u>
	Required revenue before tax	6,824
	Less: Recommended operating expense	
	before income taxes	<u>(6,005)</u>
	Required margin subject to tax	819
	Times: Gross up factor	<u>1.2255</u>
	Required net operating income	
	before income taxes	1,003
	Add: Recommended operating expense	<u>6,005</u>
	Required revenue	<u>\$ 7,008</u>
⁸	Revenue requirement	\$ 7,008
	Less: Normalized revenues	<u>(2,784)</u>
	Required increase in revenues	<u>\$ 4,224</u>

the rates in Appendix A, attached hereto and incorporated herein, be approved for services rendered.

E. Signatures

Jack Scott Lawless, CPA
Prepared By: Jack Scott Lawless, CPA
Public Utility Financial
Analyst
Water and Sewer Revenue
Requirements Branch
Rates and Tariffs Division

Brent Kirtley
Prepared By: Brent Kirtley
Public Utility Rate
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Communications, Water and
Sewer Rate Design Branch
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APPENDIX A
TO STAFF REPORT CASE NO. 92-278

The Staff recommends the following rate be prescribed for customers of Woodland Preston Enterprise, Inc.

Customer Class

Rates

Residential (Single Family)

\$20.15 per month

APPENDIX 6
 CO STAFF REPORT FOR CASE NO. 72-178

Woodland Preston Enterprises
 Statement of Adjusted Operations

	Test Year	Adjustments	Pro forma Present Rates
Operating revenue	\$2,451	\$333	\$2,784
Operating expenses			
Operation and Maintenance			
Collection system	167		167
Utility service	34		34
Fuel and power	935		935
Outside services	572	34	
		1,080	1,086
Owner/Manager fee		2,400	2,400
Total Oper. and Maint.	1,758	3,514	5,272
Depreciation	518	(24)	594
Taxes Other Than Income Taxes			
Property	84		84
PSC assessment	50		50
Verification report	4		4
School Tax	23	(23)	0
Total Taxes Other Than Income Taxes	162	(23)	138
Income Taxes			
Federal	0	(464)	(464)
State	0	(129)	(129)
Total Income Taxes	0	(593)	(593)
Total Operating Expenses	2,538	2,874	5,412
Net Operating Income	(\$87)	(\$2,541)	(\$2,628)